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Alaska Housing and the Recession

The recession that started at the end of 1985 turned the Alaska housing market on its head. Prices of houses, condominiums, and mobile homes—especially the last two—have come down so far that Alaskans have been left queasy and disbelieving. Recent ISER economic projections are for the recession to end in 1988, and a *gradual* economy recovery to begin—*if* oil prices remain stable in the $16- to $20-per-barrel range. Oil prices are the crucial element in ISER's projections. But if the Alaska economy does begin to recover in 1988, the effects of the recession on the housing market will not disappear overnight.

Since the end of 1985 Alaska has lost jobs, population, and income.[1] We now have much more housing than there is demand for. In Anchorage alone in 1987 nearly 14,000 housing units—including both owner-occupied and rental units—were vacant.[2] Thousands of Alaska houses, condominiums, and mobile homes have been foreclosed on over the past two years. Even after the economy bottoms out, the housing market will be slow in recovering. This is particularly true of the market for condominiums and mobile homes in Anchorage.

Recent ISER work indicates that it will likely be well into the 1990s before real—adjusted for inflation—condominium prices in Anchorage regain their 1985 levels. There are hundreds more mobile homes in Anchorage right now than are likely to be occupied by 1992. Very few condominiums or apartments will be built in Anchorage over the next few years: the units that already exist will more than meet the projected demand.

Single-family houses should fare better—because most buyers prefer houses when they can afford them. Lower prices in the past two years have put single-family houses within the reach of some buyers who in the early 1980s might have bought condominiums or mobile homes.

Economic conditions will of course be crucial in determining the future health of the Alaska housing market. But after economic conditions, how the major lenders handle their big inventory of foreclosed properties will make the most difference to the stability of the Anchorage housing market in the next few years. If they try to quickly sell large numbers of those properties, they will further depress prices and increase loan defaults.

Depressed prices and large numbers of loan defaults are serious problems for all Alaska homeowners and mortgage lenders—but particularly for AHFC, which holds more than 60 percent of the outstanding residential mortgages in the state.

This publication has two main parts. The first part describes conditions in the Alaska housing market in 1987, and contrasts them with conditions during the economic boom of the early 1980s. Those descriptions set the stage for the second part, which

This **Review** *is the second of two publications based on* **Alaska's Economy and Housing Market**, *a report ISER recently prepared for the Alaska Housing Finance Corporation (AHFC). AHFC commissioned the report to help the corporation in its efforts to stabilize the Alaska housing market. The first publication summarized the economic forecasts in the ISER report; this one discusses the report's findings on the housing market.*

[1] See "Alaska's Economy: What's Ahead?" *Alaska Review of Social and Economic Conditions*, December 1987, Vol. XXIV, No. 2, University of Alaska Anchorage, Institute of Social and Economic Research.

[2] Vacancies as of July 1987, as reported by the Municipality of Anchorage's Community Planning Department in *1987 Anchorage Population Profile*, December 1987.

Winter scene in a residential area of south Anchorage. *Photo: Bob Hallinen/Anchorage Daily News*

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Alaska Housing and the Recession

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reports on how various policies available to AHFC and other lenders might affect the housing market.

ALASKA MORTGAGES AND FORECLOSURES

National Secondary Lenders

Alaskans planning to buy houses generally apply for mortgage loans at banks or savings and loans or mortgage companies. These institutions—known as primary lenders—process the applications, approve or disapprove the loans, and collect the monthly mortgage payments. But very rarely do the banks themselves actually hold the mortgages: they sell almost all of them on the secondary market. In fact, primary lenders as a rule won't make a mortgage loan without first determining that a secondary lender will buy it. This system greatly reduces the risks for primary lenders in making long-term loans and frees their money for other uses.

The biggest secondary lenders nationally were created by the federal government to help increase the amount of home mortgage money available—on the grounds that a healthy housing industry is important to the U.S. economy. Of these, by far the biggest is the Federal National Mortgage Association (FNMA)—widely known as Fannie Mae—which holds about $100 billion in mortgage loans. Another—much smaller—secondary lender is the Federal Home Loan Mortgage Corporation (FHLMC, or Freddie Mac).

The Federal Housing Administration (FHA) and the Veterans Administration (VA) are federal agencies that do not actually buy mortgage loans but rather insure or guarantee them. Loans insured by FHA or guaranteed by the VA sell easily on the secondary market because they carry government backing. Most FHA-insured or VA-guaranteed loans go onto the secondary market through mortgage-backed securities that are issued by yet another federal organization—the Government National Mortgage Association (Ginnie Mae)—and are sold to investors. FHA and VA are often thought of as secondary lenders, because their backing for a loan generally insures its marketability.

The Farmers Home Administration is another federal agency that makes home loans, but only to farmers and to low-income Americans living in rural areas. This agency holds its own mortgages.

Alaska Housing Finance Corporation

The national lenders and insurers described above all operate in Alaska, but here the state government has also created several secondary lenders. The biggest is of course the Alaska Housing Finance Corporation, which holds more than $4 billion in Alaska residential mortgages, or about 60 percent of the outstanding home mortgage debt in Alaska in 1987.

AHFC is a public corporation created by the

Alaska Legislature in 1971. As a public corporation, AHFC is under the control of the state government, but it has more autonomy than traditional state agencies, and it can sell bonds to raise mortgage money.

The state legislature originally established AHFC to help Alaskans with low or moderate incomes get housing at reasonable costs. Alaska officials said that the high cost of housing in the state, the lack of mortgage money in many rural areas, and other factors was making it hard for many Alaskans to buy houses.

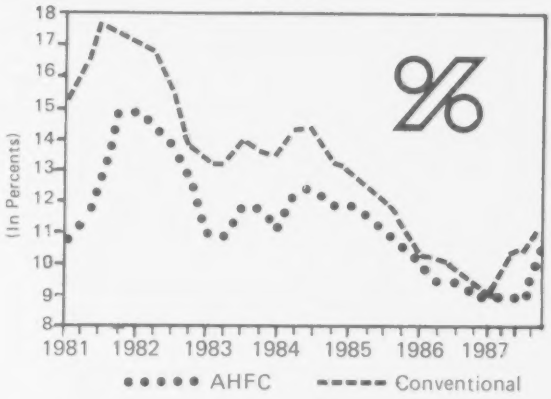
At the start of the 1980s the state legislature made several decisions that quickly transformed AHFC into the dominant mortgage lender in Alaska. National mortgage interest rates were at all-time highs, peaking above 17 percent. The legislature decided to begin subsidizing home mortgage interest rates. As Figure 1 shows, in 1981 Alaska borrowers could get a $135,000 loan from AHFC for less than 11 percent—or they could go to a national lender and pay more than 15 percent. AHFC's interest rate advantage narrowed in later years as the legislature tied AHFC's rates closer to its costs of borrowing money, but through 1985 AHFC loaned money at significantly lower rates than the national lenders.

The legislature also decided to open AHFC's lending programs to virtually all Alaskans by removing the income ceilings for borrowers, and to establish special new programs that would make it easier for more Alaskans to buy houses. Examples of those programs are the mobile home program that makes long-term mortgages available for mobile homes in trailer parks, and the Home Ownership Assistance (HOF) program that pays part of monthly mortgage payments for borrowers whose incomes aren't high enough to qualify them for conventional loans.

AHFC's lower interest rates and special programs drew 80 percent of Alaska borrowers to AHFC in the first half of the 1980s. In the past several years AHFC's share of Alaska mortgages has declined steadily. Market interest rates began dropping off sharply in 1985, and in 1987 they reached their lowest point since the 1970s. At one point in 1987 rates under AHFC's biggest loan program were the same as those of other lenders (see Figure 1).

As national interest rates fell, special conditions and restrictions on AHFC loans prompted more borrowers to look to other lenders. For example, most AHFC loans written before 1985 couldn't be assumed, and before 1986 AHFC didn't have the authority to refinance loans. Also, in 1982 the corporation had adopted the Alaska Building Equity (ABE) payment system that increases mortgage payments five percent a year from the fourth through the ninth year of the loans. Still, in 1987 AHFC remained the biggest single buyer of mortgages written for home sales.

Figure 1. Home Mortgage Interest Rates, AHFC Taxable Program and Conventional,* 1981-1987



*Mortgage rates for a $135,000 loan under AHFC's taxable program and under FNMA's 30-year, fixed-rate mortgages.

Since 1980 AHFC has raised several billion dollars in mortgage money by selling bonds. The legislature appropriated about $1 billion for AHFC mortgage subsidies between fiscal years 1981 and 1984. For the past several years, AHFC has had a revolving loan fund and received no subsidies.

Other Sources of Mortgage Money

The Alaska Department of Community and Regional Affairs also acts as a secondary lender, but it buys loans only in the most remote areas of Alaska. Its operations are small as compared with AHFC's, and it gets its loan money not through bond sales but through state appropriations.

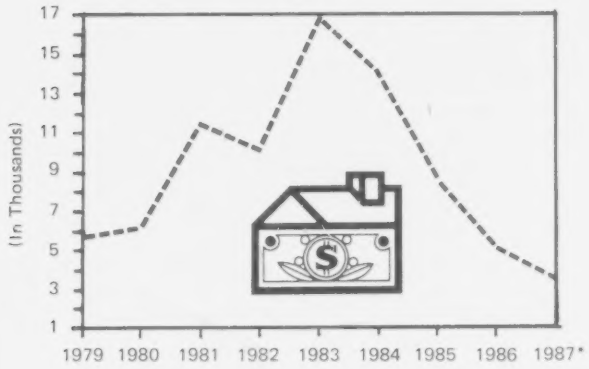
The managers of the Alaska Permanent Fund and the state pension funds (the Public Employees Retirement System and the Teachers Retirement System) also buy some residential mortgage loans—but not many as compared with the other secondary lenders, and frequently those that exceed the loan limits of other lenders. In recent times, however, those agencies have bought very few loans.

There are a variety of others who hold some Alaska mortgage loans. Credit unions hold rather than sell some mortgages. Individuals sometimes finance the sale of their own houses. Figures on mortgages held by those and others are not available, but they are few compared with those held by the big lenders.

Mortgage Activity, 1979-1987

Figure 2 marks the ups and downs of housing sales in Alaska from 1979 through 1987: it shows the numbers of mortgages written for home sales. (The figure excludes mortgages for refinancing, which are shown in Figure 3.)

Figure 2. Alaska Mortgages Written for Home Sales, 1979-1987*



*1987 figure is an estimate based on numbers for the first six months of the year.

About 5,500 mortgages worth $380 million were written in Alaska in 1979. That was a slow year as compared with what was to come. The economic boom created by construction of the trans-Alaska pipeline was over; some people were leaving the state; and mortgage interest rates were on their way up. Mortgage activity in 1980 was not much higher, but the stage was set for the next boom. High oil prices were fattening the Alaska treasury. The state government began spending its oil revenues in many ways that sparked unprecedented economic growth. At the same time, the legislature also voted to subsidize mortgage interest rates.

The economic boom created by state spending drew tens of thousands of people into the state. The combination of a burgeoning population, growing incomes, and special programs tripled numbers of new mortgages between 1979 and 1983, when more than 16,500 mortgages for home sales were written. Numbers of new mortgages began dropping in 1984, but it was in 1985 that the really sharp decline started.

The recession began toward the end of 1985, as state spending declined. In 1986 the recession worsened as oil prices plummeted. Fewer than 5,000 mortgages for home sales in Alaska were written in 1986—fewer than had been written in 1979. And in 1987 an estimated 3,000 mortgages were created for home sales in Alaska.

Figure 3. Alaska Mortgages Written for Home Sales and Refinancing, 1985-1987*

*The 1987 figure is just the first six months.

Home Refinancing

In 1985 national interest rates began dropping sharply, and many Alaskans who held home loans at much higher rates refinanced their houses. As Figure 1 shows, AHFC's subsidized rates in 1982 were as high as 14 percent; by late 1985 conventional and AHFC rates were below 11 percent. And in 1986 and early 1987 rates were near 9 percent.

Firm figures on how many mortgages are written for Alaskans refinancing their homes are hard to get. Figure 3 shows our estimates of how many mortgages written in Alaska in 1985, 1986, and the first half of 1987 were for refinances and how many for sales. Presumably there was very little refinancing before 1985, when interest rates were much higher.

The figure shows that in 1985 less than 20 percent of the 10,000 mortgages created in Alaska were for refinancing. In 1986, 15,000 mortgages were written—but more than 10,000 of those, or 70 percent, were for refinancing. In the first half of 1987, more than 60 percent of new Alaska mortgages were for refinancing.

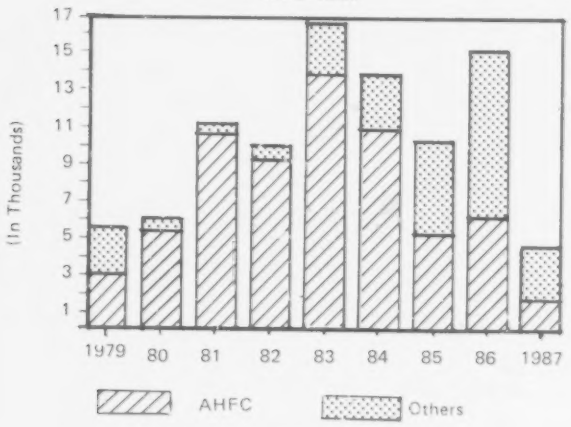
AHFC's Market Share

Figure 4 clearly shows why AHFC is the biggest mortgage holder in Alaska: it identifies shares of total mortgages (including those for sales and for refinances) AHFC and other lenders bought each year from 1979 through the first half of 1987. From 1980 through 1982, when AHFC's rates were several percentage points below those of other lenders, AHFC bought 90 percent or more of new mortgages. Through 1984 AHFC still had 80 percent of the market. In the past several years interest rates and terms of other lenders became more competitive. AHFC's share dropped from about 50 percent in 1985 to less than 40 percent in the first half of 1987.

1987 Mortgage Holdings of Major Alaska Lenders

What is at stake in the Alaska housing market? How much home mortgage debt is there in the state? Table 1 shows the mortgage holdings of major Alaska lenders as of mid-1987.

Figure 4. AHFC's Share of New Alaska Mortgages,[a] 1979-1987[b]



[a]Includes mortgages for sales and for refinances.

[b]Figures for just the first six months of 1987.

In 1987 the major lenders in Alaska held more than 84,000 home mortgage loans worth $7 billion dollars. The biggest mortgage holder is AHFC, which as of June held more than 52,000 home mortgages with an outstanding balance of about $4.3 billion. Other state government entities held another 3,000 loans with a balance of $230 million.

National lenders and insurers are also carrying tens of thousands of loans. AHFC holds some FHA-insured and VA-guaranteed loans; to avoid double-counting, those are included in AHFC's holdings and excluded from FHA's and VA's. In addition to those held by AHFC, there were nearly 8,500 FHA-insured loans and 8,600 VA-guaranteed loans in Alaska in 1987, with a combined unpaid balance of $1.6 billion. FNMA and FHLMC were each carrying more than 5,000 mortgage loans with a combined balance of nearly $900 million.

Table 1

Residential Mortgage Holdings of Major Alaska Lenders, June 1987[a]

	Number of Loans Outstanding	Unpaid Principal Balance ($ millions)
AHFC		
Mobile Homes	4,760	$ 151
AHFC/FNMA[b]	10,722	1,170
AHFC/Other	36,686	2,967
Total	52,168	$4,288
FNMA[c]	5,471	$400
FHLMC[d]	5,152	479
FHA Insured[e]	8,437	844
VA Guaranteed[f]	8,602	763
Alaska Dept. of CRA[g]	1,194	123
Farmers Home Admin.[h]	1,322	106
Alaska Permanent Fund	300	42
Alaska Pension Funds[i]	NA	NA
AIDA & Div. of Invest.[j]	1,565	68
Total	84,211	$7,113

[a]As of June 1987, unless otherwise noted.

[b]These are loans financed with FNMA money from early 1984 through 1986; AHFC makes principal and interest payments to FNMA on collateralized notes. FNMA is, however, liable for any losses not covered by private mortgage insurance if borrowers default.

[c]Excluding loans cited in note b; these are loans purchased from banks and other primary Alaska lenders.

[d]Figures are for FHLMC loans serviced by Alaska lenders as of June 1987; they may include some loans on homes outside the state but serviced by Alaska lenders and exclude some loans on Alaska homes that are serviced by lenders outside the state.

[e]Outstanding loans as of December 31, 1986, excluding AHFC loans insured by FHA. The unpaid principal balance is an estimate, based on average size of outstanding loan. Although FHA is an insurer rather than a lender, FHA-insured loans are included here because most of those loans go to lenders other than those listed in this table. Most FHA-insured loans go into mortgage-backed securities (MBSs) issued by the Government National Mortgage Association (GNMA) and sold to various investors.

[f]Figures as of March 31, 1987, excluding VA-guaranteed loans held by AHFC. A very large share of new VA-guaranteed loans in Alaska in the first half of the 1980s were purchased by AHFC. Most VA-guaranteed loans not purchased by AHFC go into MBSs issued by GNMA and sold to various investors.

[g]As of March 1987.

[h]Outstanding loans as of May 1987. Unpaid principal balance is an estimate based on average size of outstanding loan.

Good estimates of cumulative Alaska residential mortgage holdings of the pension funds are not available because figures on such holdings are combined with figures on other mortgage holdings of the funds.

[i]These are mortgage loans made under a state veterans' loan program that no longer exists; it was replaced in the early 1980s by the state veterans' program administered by AHFC. Most of these loans are now held by the Alaska Industrial Development Authority (AIDA); the Division of Investments in the Alaska Department of Commerce and Economic Development holds a few and services those held by AIDA.

Source: *Alaska's Economy and Housing Market*, ISER Report, October 1987, Tables 3.1 and 3.3.

Mortgage Liabilities

The current recession has pushed thousands of Alaska homeowners into default and foreclosure. Before we look at 1987 figures on properties in foreclosure, we'll broadly outline liability on mortgage loans when borrowers default. When we say "mortgage liabilities," we mean just losses lenders and borrowers take when individual borrowers default. There are of course other kinds of liabilities—for instance, AHFC is liable for payment on the billions of dollars in bonds it sold to finance mortgage loans. We don't discuss that or other potential liabilities here.

Table 2 summarizes insurance requirements and liabilities of home buyers and major lenders. When agreeing to make a mortgage loan, lenders generally require two kinds of protection against default. The first step is requiring a down payment, generally 5 to 10 percent of the sales price. The chief exception is the Veterans Administration program, under which qualified veterans can borrow up to a specific amount with no money down.

Second, lenders typically require borrowers to carry private mortgage insurance (PMI) on loan amounts above 70 to 80 percent of the purchase price. If the borrower defaults, the private mortgage insurer pays the lender any losses on the insured portion of the loan. Loans in remote areas of Alaska generally don't carry private insurance because it usually isn't available in those areas. Loans held by the Alaska Department of Community and Regional Affairs and the Farmers Home Administration are uninsured. Also, some loans made before 1980 under various state loan programs are uninsured.

So what happens when a borrower defaults and his property goes into foreclosure? First, borrowers who default lose their down payments and any additional amount they've paid on the loan principal.

Another liability borrowers face is that lenders may institute what is known as a judicial foreclosure. If a lender believes that a borrower who defaulted could have continued to make his payments but chose not to, he may go to court to try to make the borrower liable for any losses when the property is re-sold. In a non-judicial foreclosure, the lender accepts that the borrower has neither the income nor the assets to meet his payments and does not press for any further liability. (Damage that defaulting does to a borrower's future credit is also certainly a loss, but a less measurable one.)

The losses that lenders and insurers face when properties go into foreclosure are complicated to calculate. The biggest factor is the condition of the housing market. If prices are rising, insurers and particularly lenders don't generally lose money—because they can expect to re-sell the relatively few properties that go into foreclosure for enough to cover the outstanding mortgage and foreclosure costs. But when prices are falling—as they have been in Alaska over the past two years—it's a different story: there are thousands of foreclosed properties and they frequently sell for less than the outstanding mortgage, especially if the mortgage was written when prices were at their peak.

In Alaska's housing market today, insurers face the first losses when properties with private mortgage insurance go into foreclosure. They try of course to keep those losses to a minimum, and they have two broad choices. The insurer can take a foreclosed property and re-sell it, or the insurer can let the lender re-sell it and pay the lender a claim up to the maximum insured amount.

Say for example that a property with a $100,000 outstanding mortgage goes into foreclosure, and that private mortgage insurance covers $20,000 of that mortgage.[3] Estimate the foreclosure costs at $5,000. Suppose the insurer thinks the property will be hard to re-sell (which means that there will also be substantial interest and other holding costs) and that it might command only $70,000 when it does sell. If the insurer took the property, held it, and re-sold it at a depressed price, his costs could easily exceed $35,000. On the other hand, if the insurer let the lender take the property and simply paid the maximum insurance claim, he would limit his costs to $20,000. Only in cases where the insurer thinks he can keep his costs below the maximum insurance claim will he be likely to try to re-sell it himself.

What about lenders? What losses do they take in foreclosures? Again, in a market where prices are rising, lenders who require down payments and mortgage insurance don't generally take any losses. But in the Alaska market today, values of many properties are so much lower than the outstanding mortgages that insurance doesn't cover all the losses. And on loans not covered by insurance, lenders take all the losses.

AHFC's liability on mortgage loans varies considerably among loans made at different times and under different programs, as Table 3 shows. But AHFC has better protection than most lenders on the majority of loans it made between 1981 and 1986. Most AHFC loans made during that period carry private mortgage insurance and additional features that limit AHFC's liability.

Most AHFC loans made between 1981 and early

[3]These figures are simplified to make the example straightforward. To show precisely how much private insurance covered of any given loan we would have to know original purchase price, size of down payment, subsequent payments on principal, and amount of insurance the lender required.

Table 2

Liability* in Home Foreclosures

Lender	Insurance Requirements	Liability of Borrowers in Foreclosure	Liability of Lenders in Foreclosure
FNMA/FHLMC	Borrowers required to carry private mortgage insurance (PMI) on loan amounts above 80% of the house price.		Lender liable for any losses not covered by PMI.
FHA-Insured Loans	Borrowers pay premium for government insurance, either in lump sum or as part of monthly payments.		FHA liable for all losses.
VA-Guaranteed Loans	The federal Veterans Administration guarantees up to $27,500 on mortgage loans to veterans as a benefit of military service; this guarantee takes the place of private mortgage insurance.	*Borrowers in all cases lose their down payments, which can be as low as 0-5% but are generally 10% or more of the purchase price. Also forfeited is any amount subsequently paid on the loan principal. And, in some cases, lenders will undertake judicial foreclosures, in which they go to court to try to make borrowers who default liable for losses on resale of the properties.*	VA liable for losses up to $27,500 on each loan; additional liability falls on primary or secondary lender.
Farmers Home Administration	This federal agency makes loans to low-income households in rural areas; no private mortgage insurance.		Farmers Home Administration liable for all losses.
State of Alaska			
AHFC	Most borrowers required to carry private mortgage insurance on loan amounts above 75% to 80% of the house price; on mobile home loans, borrowers must carry private credit insurance on 40% of the loan amount.		Varies substantially among different types of loans; see Table 3.
DCRA	Loans in rural areas; no private mortgage insurance required (because it is not available in many cases).		DCRA takes all losses.
Ak Permanent Fund	Borrowers required to carry private mortgage insurance on loan amounts over 70% of the house price.		Permanent Fund bears any losses not covered by PMI.
Division of Investments and AIDA	These loans were made to veterans before 1981 through the former Division of Veterans Affairs; no private mortgage insurance required.		Losses accrue either to Veterans' Revolving Loan Fund or AIDA.

*Includes just losses the various parties may be liable for when individual loans go into foreclosure; does not include AHFC's liability for repayment of bonds and notes financing the loans, or other kinds of liabilities.

1984 carry pool insurance—insurance that covers any losses not covered by private mortgage insurance. Mortgage Guarantee Insurance Company (MGIC) provided that pool insurance as a provision of bonds AHFC sold to finance loans during that period. So AHFC has virtually no liability when borrowers default on those particular loans.[4]

From 1984 through 1986, the national lender FNMA financed a large share of AHFC loans—and on those particular loans, FNMA rather than AHFC is liable for any losses not covered by private insurance. (AHFC is, of course, liable to re-pay principal and interest to FNMA on the notes that financed the loans.)

AHFC's liability on other loans varies, as Table 3 shows. Some loans it took over from earlier state loan programs carry no insurance. Mobile home loans made before 1983 carry no insurance; loans made after that time carry private credit insurance on 40 percent of the value of the loan. AHFC takes losses beyond what private credit insurance covers.

[4]However, the pool insurance is in effect only until the bonds financing the loans have been paid off—when the bonds are paid off, AHFC becomes liable for losses not covered by private mortgage insurance.

Homes in Foreclosure

We've seen the mortgage holdings of major lenders and how the losses are divided up when borrowers default. Now we turn to the grim evidence of Alaska's battered housing market: properties in foreclosure.

Table 4 shows foreclosed properties held by the major lenders and insurers as of mid-1987. In June 1987, lenders and insurers were holding more than 4,200 foreclosed properties. During the preceding 18 months, they had sold an additional 1,600 properties that had been foreclosed on. Taken together, the foreclosed properties still in inventory and those re-sold during the preceding year and a half totaled nearly 5,900—or 7 percent of outstanding residential mortgages in Alaska in mid-1987. And there were doubtless other foreclosures not recorded on Table 4—properties held by individual banks and private mortgage insurers other than MGIC, for instance. Reliable figures on such foreclosures are hard to get.

Table 3

AHFC's Liability* in Foreclosures

All Loans Except Mobile Homes	AHFC Liability
Loans with private mortgage insurance and pool insurance; include most loans made from 1981 to early 1984.	None, until bonds carrying pool insurance provision are paid off; then AHFC liable for any losses not covered by PMI.
Loans with private mortgage insurance that were financed by FNMA, 1984-1986; include most loans made during that period.	None. FNMA is liable for any losses not covered by PMI on loans it financed for AHFC during this period.
Loans with just private mortgage insurance; include some loans made throughout AHFC history and almost all loans made since January 1987.	AHFC is liable for any losses not covered by PMI.
Loans with no insurance; include loans made under several special programs that no longer exist.	AHFC liable for all losses.
Loans with federal government insurance or guarantee; include loans made throughout most of AHFC's history.	FHA takes all losses on FHA-insured loans. VA takes liability only up to $27,500 on each VA-guaranteed loan; AHFC liable for additional losses.
Mobile Home Loans	
Loans before 1983 with no insurance.	AHFC liable for all losses.
Loans since 1983 with private credit insurance.	AHFC liable for losses not covered by PCI.

*Includes just losses AHFC is liable for when individual borrowers default.

It's no surprise that AHFC held about 65 percent of foreclosed properties in mid-1987. AHFC bought most of the new mortgages written in Alaska in the 1980s and in particular most of those written when prices were at their peak. Also, from 1980 on, AHFC bought almost all the mortgage loans on mobile homes—which have seen tremendous losses in value during the recession.

FNMA, FHA, and VA were also holding several hundred properties each in the middle of the year. Other lenders held fewer. The 100 properties that the insurer MGIC was holding at that time were just properties it had actually taken title to; remember that MGIC carries substantial liability on properties that are in AHFC's inventory.

We don't have foreclosure figures more recent than mid-1987 for most individual lenders, but we do have them for AHFC through the end of 1987. We know that, like AHFC, other lenders continued to add to their inventory of foreclosures in the second half of the year.

Table 5 and Figure 5 document the relentless climb in AHFC's inventory of foreclosures from 1984 —before the start of the recession—through 1987. At year-end in 1984, AHFC held just 129 properties. By the end of 1985 that had grown to more than 500, and in 1986 to more than 1,600. At the end of 1987 AHFC held 3,700 properties. If we compare those figures with the mid-1987 figures in Table 4, we see that at the end of 1987 AHFC held 1,000 more properties than it had six months earlier.

Table 6 shows a more detailed breakdown of properties in AHFC's inventory as of the end of 1987: 1,325 single-family houses and duplexes, 1,171 condominiums and townhouses; 1,192 mobile homes; and 13 triplexes and fourplexes.

It's easy to see why the problems in the condominium and mobile home markets are more severe than in the market for single-family houses: there are a great many more single-family houses in Alaska

Table 4

Inventory of Foreclosed Properties Held by[a] Major Alaska Lenders and Insurers, June 1987

	Held in Inventory June 1987	Foreclosed Properties Sold 1986-June 1987
AHFC		
Mobile Home	965	143
Other	1,793	1,075
Total	2,758	1,218
FNMA	394	160[e]
FHLMC[b]	78	–
FHA-Insured	385	87
VA-Guaranteed[c]	366	80
MGIC	105	25[f]
Alaska Dept. of CRA	40	1
Farmers Home Admin.	100	30
Alaska Permanent Fund	23	11
AIDA and Div. of Invest.	5	6
Others[d]	NA	NA
Total	4,254	1,618

[a]Properties "held by" each lender or insurer include just those to which each already held title or was in the process of acquiring title as of June 1987.

[b]Includes both completed and nearly completed foreclosures.

[c]Includes both properties the VA had already acquired title to and pending title acquisitions. Excluded are properties that the VA paid claims on but did not take possession of. Most such properties probably went into AHFC's inventory of foreclosed properties; some ended up in the hands of mortgage companies, banks, or other primary lenders.

[d]Some foreclosed properties are held by a wide range of Alaska banks, other primary lenders, and private mortgage insurance companies other than MGIC. Figures on such holdings are extremely difficult to get, and the numbers are small compared with the holdings of the secondary lenders and largest insurers.

[e]Properties sold 1986–May 1, 1987.

[f]Estimated sales from November 1986–June 1987.

Sources: See Sources, Table 3.1, *Alaska's Economy and Housing Market.*

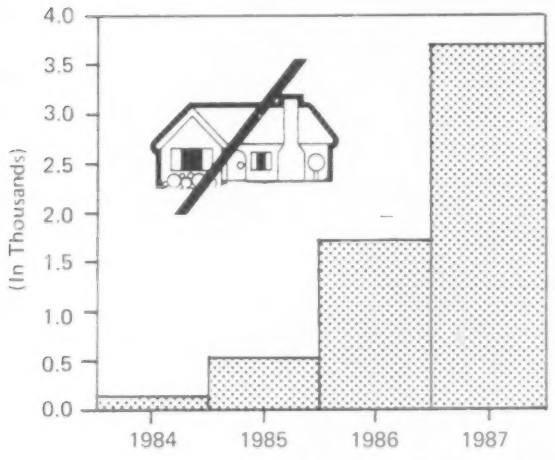
Table 5

AHFC Cumulative Inventory* of Foreclosed Properties, Year-End, 1984-1987

	1984	1985	1986	1987	% of 1987 Total
Mobile Homes	38	186	610	1,192	32%
Other	91	322	1,061	2,509	68%
All	129	508	1,671	3,701	100%

*The year-end inventories are total properties foreclosed on minus those resold. These figures are AHFC's statewide inventory.

Figure 5. AHFC Year-End Inventory of Foreclosed Properties, 1984-1987



than there are either condominiums or mobile homes, but there are just about as many mobile homes and condominiums in foreclosure as there are single-family houses.

As the last column of the table shows, houses and duplexes made up more than 75 percent of active AHFC loans in 1987, but just 36 percent of foreclosures. By comparison, condominiums and townhouses made up 15 percent of total loans but 32 percent of foreclosures. Mobile homes, while making up just 7 percent of active AHFC loans, accounted for 32 percent of foreclosures.

Table 6

AHFC Inventory of Foreclosed Properties, Year-End 1987

	Number of Foreclosures	Percent of Total Foreclosures	Active AHFC Loans by Type
Single-Family Houses & Duplexes	1,325	36%	77%
Condominiums & Townhouses	1,171	32	15
Mobile Homes	1,192	32	7
Triplexes & Fourplexes*	13	1	1
Total	3,701	100%	100%

Source: AHFC.

*Although AHFC loans by type give us a good idea of the composition of housing stock in general, this is not true of triplexes and fourplexes, of which AHFC finances few. Most are financed by other lenders.

POLICY OPTIONS

Future economic conditions will be the biggest force in the recovery of the Alaska housing market. But the next biggest force will be the mortgage lenders and insurers with big inventories of foreclosed properties. They can help stabilize the market by selling their holdings at a moderate pace rather than selling large numbers quickly—which would further depress prices and put more homeowners at risk of default.

What is the Problem?

The problem in the Alaska housing market today is that we have more housing than we have households: too many condominiums, mobile homes, houses, and apartments. Having too big a supply and too little demand has created an unstable market, where prices have already fallen dramatically and there is great anxiety about the future.

Thousands of homeowners have defaulted on their mortgages over the past two years. Some lost their jobs and were unable to keep up the payments; some had to move and were unable to sell the houses for what they still owed on them. Still others simply walked away from their properties because they had lost value. Many thousands more Alaskans are still making their payments but have negative equity—that is, their homes are worth less than their outstanding mortgages.

The big lenders and insurers are holding depressingly large inventories of foreclosed properties. They have already taken tens of millions of dollars in losses.

The worst thing for the housing market right now would be panic. If the big lenders decided to dump their inventories of housing on the market at any price in an attempt to cut their losses, they could create panic among homeowners with negative equity. Large numbers of homeowners might simply walk away from basically sound properties that will appreciate in value in the future. The result of such panic would be a continuing downward spiral of prices and many more foreclosures.

What would help the housing market most is a move toward stability: a leveling-off of prices and a reduction in defaults. Such a move toward stability would boost confidence among homeowners, and make them more likely to try to stay in their homes. Fewer defaults would ease the pressure on the lenders. Stability would help buy time toward solutions of the housing problems and eventual recovery of the market.

We are not saying that lower prices are bad for everyone and that higher prices are universally good.

Lower prices are obviously good for some Alaskans who might not have been able to buy houses a few years ago. What we are saying is that a *stabilization* of prices would be good. If prices became stable, the stage would be set for the recovery of the market and Alaskans could become more confident that housing is a good investment.

If, on the other hand, prices continue to fall and defaults persist in such disheartening numbers, investors will be reluctant to put money into the Alaska housing market in the future. That reluctance will translate into more expensive mortgage money for Alaskans. AHFC's ability to sell bonds could be hampered. Mortgage insurers might pull out of the Alaska market entirely, or charge much higher premiums for staying in.

So how can the market be stabilized? The biggest factor in the recovery of the housing market will of course be economic conditions. ISER projects that if—a crucial qualifier—oil prices remain stable in the $16-to-$20-per-barrel range, the state economy should bottom out in 1988 and begin a gradual recovery. This is our medium-case projection, and we consider it the most likely, if oil prices stay in that range. The economic recovery would be faster over the next several years if oil prices suddenly rose to around $25 a barrel (our high-case projection) and stayed that high. At the other extreme, if oil prices dropped to $15 a barrel or less and stayed that low for many months, the economy could continue to decline into 1989 and we would see very little growth over the next few years (the low-case projection).[5]

The next biggest factor in stability of the housing market will be—for reasons we describe below—sales of foreclosed properties. In the following pages we assess how rates of foreclosure sales and other factors could affect the Anchorage housing market between now and 1992.[6] We don't have enough information to make such assessments for housing markets in other areas of the state, but movements in the Anchorage market will reflect general trends in housing markets throughout Alaska—with some obvious regional differences.

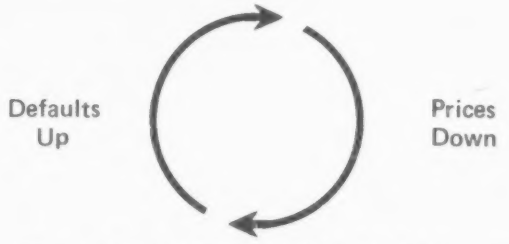
An important point to keep in mind is that we cannot forecast what is going to happen in the Anchorage housing market. To do that we would have to know how many foreclosed units the institutional sellers are going to put on the market and at what rate. What we can show are effects on the market of various rates of sale.

[5]Those economic projections appear in "Alaska's Economy: What's Ahead?" *Alaska Review of Social and Economic Conditions*, Vol. XXIV, No. 2, December 1987.

[6]Anticipating what may happen is of course complicated by the fact that each lending institution has its own interests in and constraints on holding foreclosed inventory.

Sliding Prices and Rising Defaults: A Vicious Circle

Figure 6



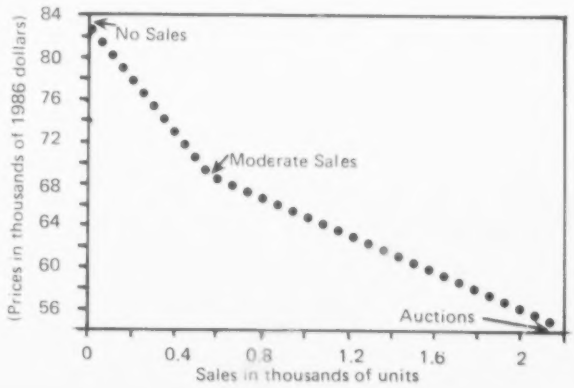
The faster AHFC and other big lenders and insurers put foreclosed properties on the market—at the extreme, through large auctions without bid floors—the more prices will be depressed and defaults persist, as illustrated by Figure 6. More defaults will mean the lenders will end up with even more foreclosed properties.

Flooding the market with housing pushes prices down. As prices go down,–more and more homeowners find themselves with negative equity—that is, their mortgages are larger than the market prices of their properties. If owners with negative equity are forced to sell, many will likely default because they are unable or unwilling to make up what can be a very substantial difference between what they owe and what the properties will sell for.

Also, a continuing downward spiral of prices erodes confidence among would-be buyers and existing homeowners. Alaskans who might be attracted by lower housing prices won't buy if they think prices could go much lower. Demand for housing could dry up. Existing owners with negative equity become more likely to walk away from their properties if the value continues to drop and they can see no turnaround in sight.

Figure 7 illustrates how prices of Anchorage condominiums are related to the number of fore-

Figure 7. Relationship Between Real Prices and Sales of Foreclosed Anchorage Condominiums, 1988



closed units on the market. The prices shown on the vertical axis of the figure are for a particular kind of unit and are *not* intended to represent average prices of all condominiums on the Anchorage market. (We know that in recent months condominiums in Anchorage have sold for as little as $25,000 and as much as $100,000.) What we are showing here is how different rates of sale could affect the price of the same condominium. So it is more important to look at the difference in the prices at various rates of sale than at the dollar figures.

As the figure shows, if all foreclosed condominiums were kept off the market—a very unrealistic scenario—condominium prices could be nearly 50 percent higher than if the market were flooded with condominiums through large auctions. At more moderate rates of sale, prices would be about 25 percent higher than if large auctions were held.

Holding properties off the market is of course very expensive for lenders and insurers: they pay in the neighborhood of $18 to $30 a day for each unit, depending on the size of the outstanding mortgage and the interest rate. We are not suggesting that lenders and insurers should hold onto all their foreclosed units: that simply is not feasible. We are pointing out that lenders should consider the future costs they might face if their selling policies contribute to more defaults.

Sliding property values and rising defaults have already cost Alaska lenders, insurers, and borrowers tens of millions of dollars. The foreclosure process itself is expensive. Costs of judicial foreclosures—under which the lender goes to court to try to make borrowers liable for any losses when the property is re-sold—are particularly high. And falling property values also have other social costs. For example, some homeowners who could find better jobs elsewhere don't move because they can't sell their houses for what they owe on them, and they don't want to default.

What Can Be Done?

We examined a number of policies AHFC and other lenders might try to increase demand, reduce supply, stabilize prices, and reduce defaults. Those include loosening down payment and other loan requirements; easing restrictions on owner-occupancy in AHFC-financed condominium complexes; subsidizing interest rates; removing housing stock; and limiting or transferring mortgage liability in some circumstances.

We made our analysis with a complex computer model that simulates the Anchorage housing market and incorporates ISER's medium-case economic projections. Our findings about how various policies might affect the Anchorage housing market are detailed in ISER's recent report, *Alaska's Economy and Housing Market*. Below we summarize our main findings:

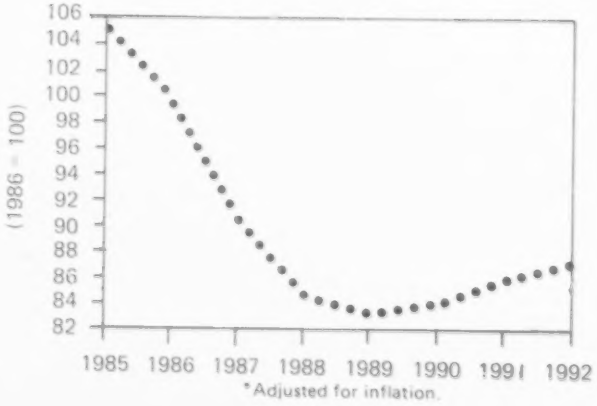
- How the big lenders manage their large inventories of foreclosed properties will be far more important than anything else they do to try to stabilize the market. If they sell those properties very quickly—at the extreme, through big auctions without bid floors—and push prices further down, the housing market will continue to be unstable and defaults will persist.

- The market for single-family houses will recover more quickly than the market for condominiums. Most buyers prefer houses when they can afford them—and today's lower prices mean houses are within the reach of more buyers. Once the economy turns around, the market should be able to absorb the inventory of foreclosed single-family houses relatively quickly. And there will be some construction of single-family houses in Anchorage over the next several years—but the total number of new houses built between now and 1992 will likely be smaller than the number built during the peak construction year of 1983.

- Very few condominiums or apartments will be built in Anchorage between now and 1992, if our medium-case economic projections prove correct. The existing supply will be more than ample to meet demand. Under that same case, real rents—rents adjusted for inflation—in Anchorage in 1992 will still be below 1985 and 1986 levels (see Figure 8).

- Because such a large proportion of Anchorage condominiums are in foreclosure, it will likely take several years beyond 1992 to sell the inventory of

Figure 8. Projected Anchorage Real* Rent Index



foreclosed condominiums without further depressing prices.

- For some Alaskans there is a silver lining in the real estate cloud: lower prices will mean that they can move into better-quality housing than they could afford before. But a big barrier for those who already own homes is that many now owe more on their houses than the houses will sell for. Lenders may want to consider a policy that allows those who want to buy better houses in Alaska to transfer a portion of their current mortgage liability to new homes.

Faster or Slower Economic Recovery

We consider our medium-case economic projections most likely, if oil prices stay in the range of $16- to $20- per barrel. The findings outlined above are based on those medium projections. But it's always possible that the economy could grow faster or slower than we expect: the Alaska economy is often surprising. If oil prices were significantly higher or lower than we assume in the medium case, the housing market would of course be affected. Figures 9 and 10 illustrate the possible range of change in two housing market variables under the low, medium, and high economic cases.

Figure 9. Real Prices, Anchorage Condominiums Under Three Cases, 1985-1992

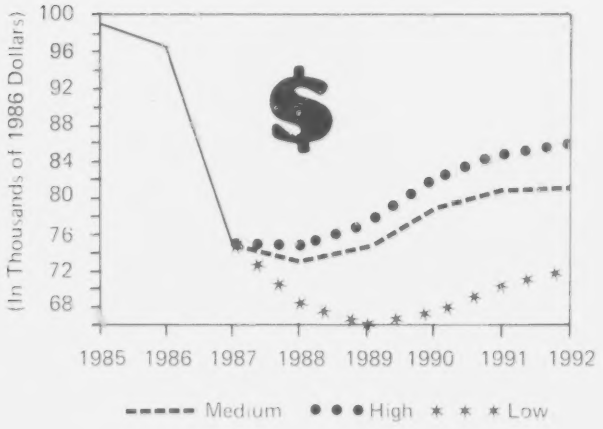
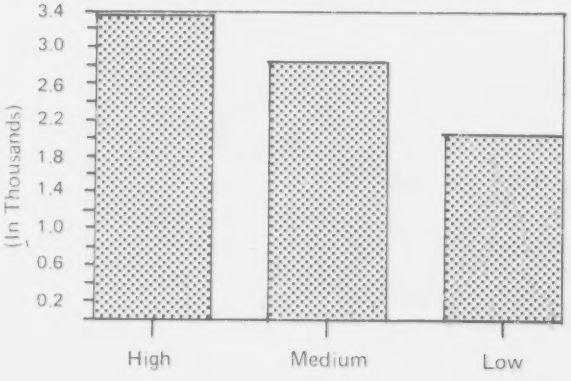


Figure 9 shows how real—adjusted for inflation—prices of Anchorage condominiums would be different under the high, medium, and low economic projections. All three cases assume the same moderate rate of sales of foreclosed properties. If more or fewer foreclosed properties were sold, the projections would change.

In the medium and the high cases, average real prices for a standard condominium would bottom out in 1988 and in the low case in 1989. Prices would then begin a very gradual recovery. But even under the most optimistic case, 1992 average condominium prices when adjusted for inflation would still be far below their 1985 peak of around $100,000.

Real prices of single-family houses should rebound faster, and—unlike the case for condominiums—a number of new houses will likely be built in Anchorage in the next few years. Figure 10 shows projected cumulative numbers of building permits for new single-family houses in Anchorage from 1987 through 1992 under high, medium, and low economic projections. Under any of the cases total construction over the next few years would be modest as compared with the frenzied building of the early 1980s: under the medium case, a total of fewer than 3,000 new houses would be built in Anchorage between now and 1992. By contrast, in 1983 alone 3,500 new houses were built in Anchorage.

Figure 10. Projected Cumulative Building Permits for Anchorage Single-Family Houses, Under Three Cases, 1987-1992



OTHER ISER PUBLICATIONS

Institute of Social and Economic Research (ISER) publications over the past 25 years have looked at virtually all the major economic and social issues facing Alaska. A list, by topic, of hundreds of ISER publications is available from ISER in the library building on the campus of the University of Alaska Anchorage (phone 907-786-7710). Below are brief descriptions of some recent work which ISER produced or contributed to. Unless otherwise noted, all publications are available from ISER, University of Alaska Anchorage, 3211 Providence Drive, Anchorage, Alaska 99508 (907-786-7710).

Alaska State Government and Politics, *edited by Gerald A. McBeath, professor of political science with the University of Alaska Fairbanks, and Thomas A. Morehouse, professor of political science with ISER, University of Alaska Anchorage. Published by University of Alaska Press, 1987, 400 pages. Soft-cover copies $17.00 and hardbound $27.00, plus $1.50 for postage and handling if ordered by mail. Available from University of Alaska Press, Signers' Hall, University of Alaska Fairbanks, Fairbanks, Alaska 99775-1580.*

The first book that comprehensively describes Alaska state government and politics is now available from the University of Alaska Press. The book describes the authorities, organization, and functions of state government as well as the people and the events that put life into government operations. It also discusses the private forces that influence government, including the press, public opinion, and interest groups. The book was written by eleven political scientists and one historian, all of whom now teach or previously taught at the University of Alaska. Several of the authors have also been directly involved in state government.

Native Claims and Political Development, *by Thomas A. Morehouse, professor of political science with ISER, University of Alaska Anchorage. ISER Occasional Paper No. 18, October 1987, 28 pages. Available for $2.00 from ISER.*

This paper discusses six existing and proposed settlements of Native claims in Alaska and northern Canada. The author assesses how such settlements fit into the broader, ongoing process of Native political development; he argues that claims settlements should be seen not as "final" political solutions but rather as important junctures in a continuing process of political development.

Report on Alaska Benefits and Costs of Exporting Alaska North Slope Crude Oil, *May 1987. Prepared by ISER for the Finance Committee of the Alaska State Senate by Matthew Berman, Susan Fison, Arlon Tussing, and Samuel VanVactor. Report findings and conclusions available from ISER for $1.50; technical appendixes available at 10 cents per page.*

This report finds that Alaska could reap fiscal and other economic benefits amounting to billions of dollars in the coming years if the federal government agreed to lift the existing ban on the export of crude oil from Alaska's North Slope. It also concludes that such exports would help reduce the United States' balance-of-payments deficit, and that overall the benefits of lifting the ban would far outweigh any potential costs.

Alaska's Constitution: A Citizen's Guide, *by Gordon S. Harrison, former associate professor of political science with the University of Alaska Fairbanks. Published by ISER, Second Edition, 1986, 134 pages. Soft-cover copies $2.00. Available from ISER.*

Several thousand copies of this guide to Alaska's constitution were distributed before the 1982 general election, when Alaskans voted on whether to call a constitutional convention to consider revisions to the constitution. It is a concise, article-by-article explanation of what Alaska's constitutional provisions mean and how they have been tested since the constitution went into effect in 1959. Alaskans decided against calling a convention in 1982, but the guide was so popular that the author updated it for a second edition in 1986.

Alaska's Urban and Rural Governments, *by Thomas A. Morehouse, professor of political science at ISER; Gerald A. McBeath, professor of political science at the University of Alaska Fairbanks; and Linda Leask, editor and research associate with ISER. Published by University Press of America, 1984. Soft-cover copies $11.25. Available from ISER.*

This book describes all aspects of Alaska's local governments, including the sharp differences in urban and rural systems; their strengths and weaknesses; the quasi-government organizations that share government power in rural areas; the effects that big state oil revenues had on Alaska's local governments in the early 1980s; and the future of local governments around the state.

Alaska Resources Development, *edited by Thomas A. Morehouse, professor of political science with ISER, University of Alaska Anchorage. Published by Westview Press, 1984, 212 pages. Soft-cover copies $11.00. Available from ISER.*

Alaska's renewable and non-renewable resources and their potential for development are the subjects of this book. Six authors—three economists, a political scientist, a geographer, and a biologist—wrote individual chapters. The book cites as the chief determinants of future resource development in Alaska: (1) the costs of producing resources as compared with their market value; (2) the world political climate and the availability of secure supplies of vital resources outside Alaska; and (3) government policy. Of the three, the first is by far the most important.

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